

Message Text

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E.O. 11652: GDS

TAGS: EFIN, EAID, PO

SUBJECT:PORTUGUESE INTERNATIONAL LIQUIDITY CRISIS

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REFS: A) STATE 299551, B) LISBON 7543, C) LISBON 7486

1. AS FOLLOW-UP TO REF A, INTER-AGENCY WORKING LEVEL GROUP MET DECEMBER 22 TO DISCUSS PORTUGUESE LIQUIDITY PROBLEMS AND OPTIONS RE U.S. ASSISTANCE. THE WORKING GROUP TOOK AS GIVEN THAT (A) POLITICAL STAKES IN PORTUGAL ARE HIGH (B) IT IS IN U.S. INTEREST TO TRY TO STRENGTHEN PORTUGAL'S POLITICAL STABILITY AND (C) ECONOMIC FACTORS WILL PLAY A STRONG ROLE IN SHAPING POLITICAL TRENDS. WORKING GROUP WILL LOOK INTO DETAILS OF SPECIFIC OPTIONS OVER COURSE OF NEXT TWO WEEKS, MAKE RECOMMENDATIONS AND ATTEMPT TO EXPEDITE DECISION PROCESS. PURPOSE OF THIS TELEGRAM IS TO SHARE WORKING GROUP'S INITIAL THINKING WITH EMBASSY. ACTION REQUESTED PARA 3.

2. IN DISCUSSING THE PORTUGUESE PROBLEM, THE WORKING GROUP MEMBERS BELIEVED IT WOULD BE USEFUL TO HAVE SOME INDEPENDENT DIAGNOSIS AND PRESCRIPTION FOR PORTUGAL'S ECONOMIC ILLS. THE IMF HAS ALREADY DONE SOME ANALYSIS

AND WOULD DO MORE IF PORTUGUESE REQUESTED A CREDIT TRANCHE DRAWING. OECD TECO SURVEY TEAM SHOULD BE MAKING REPORT SOON. IT WOULD PROBABLY ALSO BE DESIRABLE (PARTICULARLY FROM THE VIEWPOINT OF EUROPEAN ASSISTANCE) TO HAVE MORE COMPREHENSIVE OECD SURVEY MISSION MENTIONED REF A, IF PORTUGUESE ARE WILLING TO REQUEST SUCH SURVEY. A REALISTIC ACTION PLAN BY THE PORTUGUESE THEMSELVES FOR ECONOMIC RECOVERY WOULD OBVIOUSLY FACILITATE INTERNATIONAL ASSISTANCE TO PORTUGAL AND WOULD LIKELY HELP MARSHAL LARGER AMOUNTS OF ASSISTANCE THAN WOULD BE POSSIBLE UNDER A PIECEMEAL APPROACH.

3. IMF. THE PORTUGUESE RECEIVED APPROVAL DECEMBER 22 TO BORROW 73 MILLION SDR (TOTAL NOW AVAILABLE, EQUALING 50 PERCENT OF THE CALCULATED MAXIMUM ACCESS) FROM THE 1975 OIL FACILITY. IN CONJUNCTION, THEY WILL ALSO DRAW 7 MILLION SDR FROM THEIR GOLD TRANCHE. WE HAVE HEARD FROM THE FUND STAFF ON A CONFIDENTIAL BASIS THAT AS SOON AS THE OIL FACILITY FUNDS ARE DISBURSED,
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THE PORTUGUESE WILL BEGIN NEGOTIATING TO DRAW ON THE

29 MILLION SDR IN THEIR FIRST CREDIT TRANCHE. IF APPROVED, TOTAL IMF DRAWING BY PORTUGAL WOULD AMOUNT TO 109 MILLION SDR. BEYOND THIS, PORTUGUESE MAY NOT BE FULLY AWARE OF POSSIBILITY OF DRAWING FROM THE IMF'S COMPENSATORY FINANCING FACILITY (CFF). THIS FACILITY PROVIDES ACCESS TO IMF RESOURCES ADDITIONAL TO THAT AVAILABLE UNDER CREDIT TRANCHES TO MEMBERS EXPERIENCING PAYMENTS DIFFICULTIES DUE TO TEMPORARY

SHORTFALLS IN EXPORT EARNINGS ARISING FROM FACTORS BEYOND THE MEMBER'S CONTROL. A MAJOR LIBERALIZATION OF THIS FACILITY WAS IMPLEMENTED ON DECEMBER 24 AND UNDER THE NEW ARRANGEMENTS A MEMBER MEETING THE CRITERIA COULD DRAW UP TO 50 PERCENT OF QUOTA IN A 12 MONTH PERIOD, WITH TOTAL OUTSTANDING CFF DRAWINGS LIMITED TO 75 PERCENT OF QUOTA. IN PORTUGAL'S CASE, THEY COULD DRAW UP TO 58 MILLION SDR IN 1976 IF THEY MEET THE NECESSARY CRITERIA. LOANS HAVE THE SAME INTEREST AND REPAYMENT TERMS AS REGULAR DRAWINGS (INTEREST RATES THAT RISE FROM 4 TO 6 PERCENT OVER THE 3 TO 5 YEARS REPAYMENT PERIOD). EMBASSY SHOULD ENCOURAGE THE PORTUGUESE TO EXPLORE THE POSSIBILITY OF DRAWING ON THIS FACILITY. ADDITIONAL IMF RESOURCES COULD BE AVAILABLE FROM (A) DRAWING ON THREE REMAINING CREDIT TRANCHES FOR TOTAL OF 88 MILLION SDR, INVOLVING IMPOSITION OF INCREASINGLY STRONGER ECONOMIC POLICY

CONDITIONS ON THE BORROWER, AND (B) FROM MORE DRAWINGS ON THE OIL FACILITY (FOR 73 MILLION SDR) IN THE EVENT THE EXECUTIVE DIRECTORS DECIDE THAT SUFFICIENT FINANCING IS AVAILABLE TO BROADEN COUNTRIES' ACCESS TO 100 PERCENT OF THE CALCULATED MAXIMUM (PROSPECTS FOR SUCH DECISION DO NOT LOOK PARTICULARLY GOOD AT THE MOMENT).

4. SWAP ARRANGEMENTS. WG BELIEVES THAT SWAPS WOULD NOT BE SUITABLE TO MEET PORTUGAL'S FINANCIAL PROBLEMS. SWAPS ARE SHORT-TERM, TEMPORARY ARRANGEMENTS (USUALLY 90 DAYS) AND DRAWINGS ON SWAPS CUSTOMARILY INCLUDE AN IMPLICIT TAKE-OUT PROVISION (I.E., THAT REPAYMENT IS COVERED BY AVAILABILITY OF OTHER LIQUID RESOURCES).

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5. TOURISM AND EMIGRANT REMITTANCES. WORKING GROUP AGREED THAT PORTUGUESE EARNINGS FROM TOURISM AND EMIGRANT REMITTANCES MIGHT BE IMPROVED SUBSTANTIALLY AND IN NEAR TERM BY UNILATERAL GOP ACTIONS. RECEIPTS FROM BOTH SECTORS RESPOND RELATIVELY QUICKLY TO PSYCHOLOGICAL FACTORS. TOURISM MIGHT BE IMPROVED CONSIDERABLY IN 1976 IF CONDITIONS REMAIN STABLE IN PORTUGAL AND IF APPROPRIATE PORTUGUESE AGENCIES UNDERTAKE AN AGGRESSIVE PROMOTIONAL EFFORT TO LURE THE TOURISTS BACK, INCLUDING MEASURES LIKE THAT REPORTED IN LISBON'S 7641. EMIGRANT REMITTANCES WOULD ALSO INCREASE IF THE EMIGRANT WORKERS HAD GREATER CONFIDENCE IN STABILITY AND VIABILITY OF PORTUGUESE SYSTEM. (FURTHER MEASURES TO ENCOURAGE REPATRIATION OF EARNINGS MIGHT BE USEFUL). BOTH SECTORS WOULD BENEFIT FROM A DEVALUATION OF THE ESCUDO BUT, TO BE EFFECTIVE, DEVALUATION SHOULD COME

SOONER RATHER THAN LATER IN 1976. WE ASSUME THAT THE PORTUGUESE ARE AS AWARE OF THIS AS WE ARE. IN ANY CASE, IT WOULD NOT BE APPROPRIATE FOR THE U.S. TO RECOMMEND DEVALUATION TO THE GOP.

6. PL-480 AND OTHER BILATERAL AID. WITHIN CONFINES OF PRESENT PL-480 PROGRAM, THERE IS LITTLE SCOPE FOR SIGNIFICANT ADDITIONAL ASSISTANCE. THERE ARE OVERALL BUDGETARY LIMITS, PROBLEMS WITH AVAILABILITY OF COMMODITIES AND CAPACITY OF PORTUGAL TO ABSORB THOSE AVAILABLE AND FINALLY THE RECENTLY IMPOSED 75-25 CONGRESSIONAL ALLOCATION RULE (UNDER WHICH 75 PERCENT OF VOLUME OF ALL PL-480 FOOD COMMODITIES MUST BE DESTINED FOR COUNTRIES WITH PER CAPITA GNPS OF \$300 OR LESS). PROSPECTS FOR MORE BILATERAL AID DO NOT

APPEAR GOOD, AS SENATE FOREIGN RELATIONS SUBCOMMITTEE HAS ALREADY PROPOSED CUT IN FOREIGN ASSISTANCE ACT AID TO PORTUGAL FROM \$55 MILLION TO NOT MORE THAN \$35 MILLION. APPROPRIATION PROCESS LIKELY TO RESULT IN FURTHER CUT IN TOTAL SECURITY ASSISTANCE ACCOUNT FROM WHICH PORTUGAL FINANCING IS DRAWN. SENATORS HUMPHREY, PELL, BROOKE AND KENNEDY HAVE INDICATED, HOWEVER, A GENERAL DESIRE TO BE HELPFUL TO PORTUGAL. WE SHALL THEREFORE EXAMINE THE
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AID/PL-480 QUESTIONS IN DETAIL TO DETERMINE WHAT, IF ANYTHING, CAN BE DONE AND POSSIBILITY OF COMMODITY CREDIT CORPORATION (CCC) COMMERCIAL CREDITS FOR AGRICULTURAL PRODUCTS (E.G., COARSE GRAINS). WE SHALL ALSO BE WORKING TO RESTORE THE \$20 MILLION FOREIGN ASSISTANCE ACT CUT.

7. GOLD RESERVES AND BALANCE OF PAYMENTS. THE IMF ESTIMATES THAT THROUGH MID-1976, PORTUGUESE AUSTERITY POLICIES ARE UNLIKELY TO REDUCE NET FOREIGN EXCHANGE LOSSES BELOW THE CURRENT LEVEL OF \$100 MILLION PER MONTH. GOLD IS KEY ITEM IN DETERMINING WHETHER THIS REPRESENTS A LIQUIDITY CRISIS. WHILE IT THUS MAY BE NECESSARY TO MOBILIZE SOME PORTION OF THEIR GOLD RESERVES, IT SHOULD BE POSSIBLE FOR THEM TO MEET THEIR NEAR TERM REQUIREMENTS WITHOUT UNDUE REDUCTION IN THEIR RESERVE HOLDINGS OR DAMAGING PSYCHOLOGICAL REPERCUSSIONS.

8. PRIVATE BANKS. WE HAVE HAD RECENT CONVERSATION WITH FNCB OFFICIAL WHO RECOGNIZED IMPORTANCE OF RECENT POLITICAL TRENDS IN LISBON AND INDICATED THAT BANK WILL BE TAKING THOSE CHANGED CIRCUMSTANCES INTO ACCOUNT IN FUTURE TRANSACTIONS WITH PORTUGAL. WE WILL BE IN CONTACT TO SEE WHAT THE PROSPECTS ARE IN THAT DIRECTION.

9. CONSULTATIONS WITH WESTERN EUROPEANS. WE ENDORSE
EMBASSY'S SUGGESTION THAT WE ENCOURAGE WESTERN EUROPEANS
TO DO MORE FOR PORTUGAL. THE FRG, IN PARTICULAR, SEEMS
TO BE FAVORABLY DISPOSED EVEN WITHOUT U.S. ENCOURAGEMENT.
WE WILL SOON INITIATE URGENT CONSULTATIONS WITH THE
EUROPEANS, INCLUDING EC, BILATERALLY AND MULTILATERALLY.
ROBINSON

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